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<u>**ENDING THE IGNORANCE: WHY THE CRA MUST ADDRESS FINANCIAL LITERACY**</u>

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When CRA was created, the intent of it was to encourage financial institutions to help meet the credit needs of the local communities in which they are were situated in. While CRA was created to help provide credit as well as deposit services to the communities that need it, Congress found that financial institutions also need to serve the convenience and needs of the communities in where they are situated. This meaning has been gradually expanded to include important "services" to communities in addition to being provided credit and deposit services. These "services" that were reviewed for CRA, while weighted differently, have become an integral and important part of the CRA test. Access to the same financial services as other communities creates a more equal, productive, and safe and sound financial system. As shown by extensive research, the majority of CRA-credited loans were not sub-prime loans. Although Low and Moderate Income (LMI) communities need financial access and products to accomplish this equal, productive, and safe and sound financial system, they also need to <u>***understand***</u> how to use them. The recent economic mortgage problem has highlighted misunderstanding of the financial products by both the consumers and the bankers offering it. This is further strengthened by the fact that various states have reacted to this lack of financial knowledge by enacting legislation to mandate financial literacy programs for students.

In considering on how to update the CRA rules to reflect current market needs, the agencies should consider the importance of financial education and they should consider giving it not only greater attention under the service test, but giving a bank "extra points" for investing in a financial literacy program that exists or is in the process of development. This testimony will now highlight some important factors why this should be implemented into new CRA regulations and thus will focus on Financial Literacy and its importance to CRA. I assume that other testimony will touch upon all other important factors or changes to new CRA regulation.

I. FINANCIAL EDUCATION AND ITS IMPORTANCE

Education has been said to not only be a life-long process, but one that emanates through multiple spheres of knowledge; from religion all the way through to job security. One area of education that has generally been ignored, is in the sphere of financial knowledge, or commonly referred to as "financial literacy." Financial literacy has been lacking for years within the United States. The financial crisis publicly rehashed this issue for the United States front and center of every news outlet. Consumers and their respective representatives blame the banks for engaging in predatory lending, that there has been a disregard for prudential financial analysis, and extreme deficiencies of accountability. The banks retort by blaming consumers for their lack of financial literacy when buying certain financial products. Professionals as prominent as former Fed Vice Chairman, Alan Blinder (currently an economics professor at Princeton University), feel that the blame isn't on the consumer but rather "most of them didn't understand what they were agreeing to."

The problem with blaming the consumer is that (1) no organization, bank, or government representative is addressing the lack of accountability for the American public's ignorance of financial literacy, (2) the financial systems that customers need to navigate have become increasingly complex, and (3) consumers have had relatively easy access to credit in this market. Literacy itself is not taught by one class but instead taught over a multitude of years of education, possibly starting from the kindergarten level leading through the 12th grade and in higher education as well. It is hard to imagine why financial literacy, arguably one of the most important fields of knowledge for anyone who is or will be a consumer, is barely even mentioned in the K-12 system.

Currently, the financial system is closely intertwined with the lives of all Americans. Credit and debt are a fact of life for nearly every American, yet there are no financial literacy programs <u>in place</u>. While some banks offer small "financial literacy" crash courses, such education should not just be a single class in a grade, but should rather be a life-long process of putting what you learn to use. The bank regulatory agencies should develop a CRA regulation that further encourages banks to invest in the financial literacy field in a way that will be practical and applicable to the American citizen, especially in these particular economical times.

II. THE ECONOMICAL STATE OF THE U.S. AND ITS CITIZENS

Single family homes and condos in foreclosures in DC for the 3rd quarter ended at the rather large number of 2915. While the 4th quarter numbers are not in, the FDIC lists statistics that are roughly estimated that nearly 3,000 Washingtonians a year will lose their homes in the continuing crisis. These numbers are for the current home-owner market in D.C. Take into account the non-home owner market of 18-24 year olds in the nation: nearly 30% of the disposable monthly income of this demographic is currently devoted to debt repayment. In fact, by 2002, bankruptcy declarations for this demographic had increased 96% meaning that more people within this group filed for bankruptcy than those that graduated college.

The United States itself has gone through some drastic changes from the times of the early 1900s. The countries GDP and export-import deficit has continuously widened, for a multitude of reasons, and the United States public has become increasingly dependent on credit and other financial systems. In 1970, our debt-to-GDP ratio was 27.96%, mostly due to the running of a strong economy (which in turn led to a strong budget surplus) and a responsible fiscal policy. Moving forward to 2010, due to 70's and 80's inflation, a few more wars, a 1980's recession, Reaganomics, social spending, a tech bubble, a terrorist attack and the most current recession, first quarter U.S. gross debt to GDP ratio rose to 87.3%. While the United States operated in a way that piled on debt, so did the average consumer.

A. CONSUMER DEBT

The average American now carries $10,000 to $12,000 in revolving debt alone. The numbers become scarier when viewed as an aggregated statistic as this excerpt from a 2008 CardWeb report shows:

> [R]evolving credit grew again in January [2008] as Americans tacked on $5.6 billion in net new debt, mostly credit card debt, compared to the prior month. In December consumers added $2.2 billion. Revolving consumer credit has now

reached a record $947.4 billion and is growing by 7.0% per annum… [R]evolving debt rose 2.8% in December and 12.8% in November. According to data released by the Federal Reserve, total revolving credit has expanded by $76 billion over the past twelve months. Bank credit card debt (excluding store and gas credit cards) at the end of the fourth quarter was about $800 billion, roughly 85% of total revolving credit, according to CardData Store and gas credit cards had about $109 billion in outstandings at year-end 2007.

The aggregate expenditure of fees (not interest) by Americans on this debt was $24 billion in credit card fees in 2004 alone. This nation of the United States has become a "nation of borrowers." The average credit card debt per person is currently over $5,000. The total credit debt for the American Consumer has risen more than $964 billion from 1968-2009. Even if you calculated the 1968 credit debt of $8 billion into 2009 dollars, it would still be over a 2000% increase over the original number. The question that begs to be answered is; why are consumers accumulating debt? Research by Dr. Neil Stewart, Psychology researcher at the University of Warwick, in his studies has found one answer. His studies show that minimum payments (required by fair credit laws) on credit card statements essentially act as "anchors" and fixate the consumer to pay this amount alone. Dr. Stewart feels this is a major concern that credit card companies, in an effort to include a "safeguard" for consumers, are actually distorting their regular behavior of payment in a way "that increases a consumer's interest charges and increases the duration of their debt". These results should be of great concern to credit card companies, but not in the way Dr. Stewart believes.

Dr. Stewart's heart might be in the right place, but he might not realize that credit card companies are following a business model that wants consumers to hold on to debt. The American consumer is advertised to, pushed to, and sold on credit cards as a wonderful thing. *How is the American Consumer to know that these credit cards are not such a wonderful thing*? Financial literacy would allow the American consumer to better evaluate and fully understand what making only minimum payments are. While there are other laws for financial disclosure and consumer protection, it proves fruitless if the consumer doesn't understand any of it. CRA can fill this hole by rewarding banks for investing in the education of its consumers.

B. THE CHANGE FROM PENSIONS TO 401K'S

In 1978, the Revenue Act of 1978 act was passed which included section 401(k), which allowed employees not to be taxed on a portion of their income that they choose to defer instead of direct payment. This section began the story of the 401k plans that we as Americans have embraced but essentially know nothing about. The importance of financial literacy becomes increasingly crucial after the transition from defined benefit retirement plans, otherwise known as "pensions," to the defined contribution plans, known mainly as 401(k)s. The same goes for Traditional and Roth IRA's that banks offer. Employees are routinely left to fend for themselves how much to defer, and where or what type of funds to invest in. The companies that offer 401k's generally don't expend resources on providing education of these plans to employees. The companies expect employees to know or to be able to figure out – *but where do the employees go for this financial education*? Again, the financial needs of these communities have changed and they are being unanswered. CRA needs to be updated to respond to these needs as financial saving and debt-usage becomes an integrally individual-defined path.

C. THE AMERICAN DREAM AND SUBPRIME MORTGAGES – AMERICAN'S MYTH

The American Dream – "It is an ingrained philosophy, a bedtime story, a salient meal even the most impoverished, starving child can feast upon and sleep at night with full, churning bellies while visions of picket fences, three car garages and Ford Expeditions dance in their heads." Work hard and you will accomplish whatever feat you can dream. What happens if you don't have the money to buy? That's not a problem. Bank of XYZ will loan it to you, and you can buy that home and pay it off slowly. The iconic reasoning used is as follows: *instead of giving your money to someone, you give it to yourself and build equity.*

For the majority of people this plan still works, but for a growing portion of society owning a house is not in their reach and sub-prime mortgages were their way out. Without going into too much detail, the answers came in the form of ARM's, Interest-Only Mortgages, and if all else fails take out a two mortgages on your first purchase to make sure you get approved. The American Dream fueled the need for homes and complicated products picked up the slack for those that couldn't get the conventional mortgage. *How were they to know that they weren't making the best decisions?*

Again, disclosure is useless without the consumer understanding what they are purchasing. If the U.S. pushed home ownership as such an important goal, perhaps its regulatory agencies should be sure that the middlemen (banks) are truly working on educating their consumers, not just through disclosure as required by other laws but by altruistic means of investing in the financial education of its communities. And if altruism isn't enough, CRA requirements should be the secondary motivating factor.

III. FINANCIAL EDUCATION FOR STATES?

While banks and the financial markets played a major role that could never be "played down," personal financial education is playing a smaller but similarly important role on financially hard-pressed citizens. While legislation is being passed to regulate the banks, what will be done about the "leaders of tomorrow?" These future leaders graduating with immense amounts of debt are not leaving our schools with the tools they need to deal with this increasingly credit-heavy society nor how to understand its importance and relevance.

When people ask who is responsible for the financial literacy of America, the majority of the states put it on the education system. Yet, not many resources are devoted to it. Thirty-eight states have some type of guidelines or standards for personal finance. Out of these thirty-eight, only twenty-one of them require these standards/guidelines to be implemented. Only eight states actually require a course that "contains" personal finance content. The States do not demonstrate a strong motivation to implement strong incentives for schools to teach financial education. In fact, only seven states even require students to take a personal finance course to graduate. This contrasts greatly with a differing viewpoint held by the American Public. 90% of adults and children believe that the United States people should not only be financially literate but "have a good understanding of economics." This begs the question of why only half of high school students say they took a class that included economics in high school.

In 2007, Mississippi and Tennessee began their states' foray into financial literacy by developing a program to train over 6,000 students through a pilot program on how to make good financial decisions for first and fourth graders respectively. But other localities aren't as fortunate. In 2007, D.C. floated ideas calling for financial literacy and rolled out a test bill which passed in 2008 establishing the District of Columbia Financial Literacy Council. This Council which was supposed to be established in 2008 by March 2010 is still working on naming its nine member board to begin operation in 2011. While governmental action normally does take some time, why is D.C. waiting on a council's formation when other states around it are already implementing financial literacy plans? This flies in the face of countless reports and studies proving that education is best learned not only at a young age but through continued curriculum. The curriculum is best integrated with other topics as Joseph Peri, Executive Vice President at National Council on Economic Education, has stated.

Why are States stalling on implementing full financial education programs or broader more systematic approaches? Budgets. Schools are tight with budgets and already competing with various funding issues that states have. CRA could fill this budget gap, by providing financial and human capital from Banks. A good financial curriculum should include the basic core topics of banking, saving, taxes, credit (small to large), investments, insurance and retirement, which are all topics for which banks have well-versed professional employees.

IV. FINANCIAL LITERACY IN CRA

The current state of the country shows consumer debt at all-time highs, more movement towards individually-defined retirement (401Ks and IRAs), U.S. focus on home ownership, and the state slow implementation of strong financial literacy programs. These factors show that the U.S. as a whole needs financial literacy programs. The spirit of CRA was to rank banks based on their contributions to the financial needs of their communities. Currently, financial literacy is one of the biggest needs of the U.S. community – why is financial education only mentioned in passing in a small passage in the CRA regulation?

Banks which serve the same financially illiterate consumer are actively *and* passively taking advantage of this fact. The Agencies need to realize this and use CRA to reward the banks that do something for their community by educating their customers. Several states and organizations are working to implement financial education system. If banks were working in conjunction through financial and/or human capital, these activities by states would be put into place faster and work in a more efficient and coordinated manner.

A. HOW SHOULD THIS BE IMPLEMENTED?

These actions directly affecting or correlated to financial literacy should be weighted more as they are highly relevant to the communities they serve. Lending is one of most important needs of communities but communities cannot themselves take lending services and products without knowing how to use them. CRA currently is rewarding banks who will give a fish to a hungry man when CRA could reward banks for giving that same fish while also teaching that hungry man how to fish on his own. While making credit available to certain communities in need, they would benefit more from that credit if they knew how to use it better.

I highly urge the agencies to consider financial literacy investments and services that banks submit for CRA as highly important to receiving an outstanding rating. This can be accomplished by creating a new "Currently-Important-Community-Needs" category that <u>must</u> be fulfilled along with or within the other categories to receive an outstanding rating. This category could be updated every few years as community needs change. In the alternative, putting more weight into investment and service side of the tests for activities that work towards financial literacy would also suffice. Whatever approach might be used, at the end of the day, financial literacy programs are an imperative need to most communities if not all of the U.S. The increasingly important financial aspects of every American's life combined with the average debt that individuals in this society operates under, are sufficient reasons alone to implement stronger focus/requirements into CRA. If Congress intended Banks to serve the convenience and needs of the communities in where they are situated, new regulations must take into account the pressing financial literacy problem of the U.S.